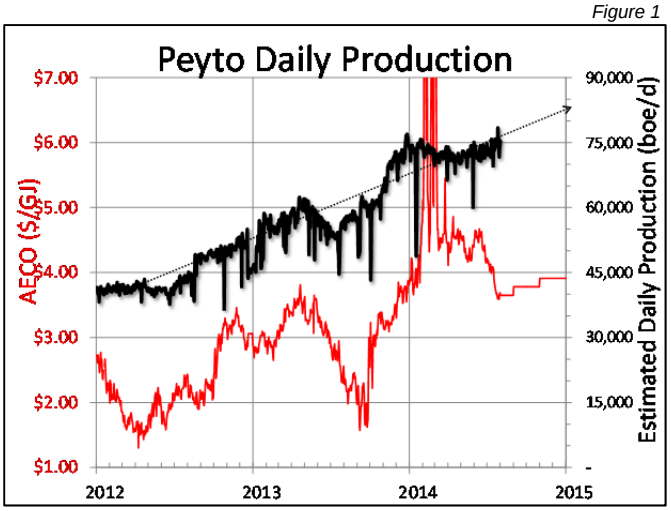
Peyto Exploration & Development Corp.
President's Monthly Report

August 2014 — From the desk of Darren Gee, President & CEO

Despite all the lightning strikes and fires across Alberta and BC this past month (floods one year, fire the next, locusts next yr…) Peyto's production has been steadily climbing higher as we finally get ahead of the base declines. Lastest daily production has been as high as 78,000 boe/d as shown in Figure 1. Gas prices have softened too, which is actually good news as it may pour some cold water on our less efficient and less profitable competition.

Figure 1



As in the past, this report includes an estimate of monthly capital spending, as well as our field estimate of production for the most recent month (see Capital Investment and Production tables below).

Capital Investment*

*2013/14 Capital Summary (millions$ CND)**

	2012	Q1	Q2	Q3	Q4	2013	Jan	Feb	Mar	Q1	Apr	May	Jun	Q2
ONR Acq./other acq.	184	0	0	0	0	0.0				0				0
Land & Seismic	12	2	6	3	2	11.9	6	0	1	7	1	0	7	8
Drilling	211	76	32	86	60	253.0	24	27	30	80	22	22	24	68
Completions	127	41	10	54	47	151.7	11	11	14	36	16	14	18	48
Tie ins	46	15	7	14	12	48.2	7	5	5	16	4	3	3	10
Facilities	37	36	18	24	34	112.2	18	11	12	40	6	4	7	16
Total	618	169	74	181	155	578	65	53	62	179	49	43	60	151

Production*

*2012/13/14 Production ('000 boe/d)**

	Q1 13	Q2 13	Q3 13	Q4 13	2013	Q1 14	Apr	May	June	Q2 14	Jul
Sundance	39.7	41.6	41.5	47.4	42.6	49.3	50.4	51.0	52.4	51.3	54.5
Kakwa	3.3	3.0	2.6	2.5	2.9	2.4	2.5	2.4	2.4	2.4	2.3
Ansell	8.8	10.7	9.9	13.9	10.8	15.7	14.3	14.8	14.0	14.4	14.0
Other	3.3	2.9	2.4	3.6	3.1	4.8	4.2	3.9	4.0	4.0	4.0
Total	55.2	58.2	56.5	67.3	59.3	72.3	71.4	72.1	72.8	72.1	74.8

**This is an estimate based on real field data, not a forecast, and the actual numbers will vary from the estimate due to accruals and adjustments. Such variance may be material. Tables may not add due to rounding.*

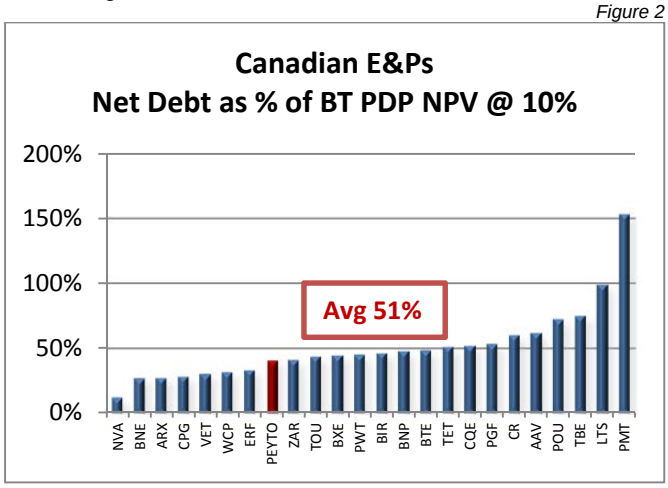
Ownership or Optionality

Most investors would agree that US producers are more levered than Canadian producers. They use more debt to aggressively fund the development of their assets and opportunities, and afterwards carry more debt on those assets. Which leaves me wondering, at any point in time, how much of the developed asset base do the banks "own" and how much do the shareholders own? And, do the shareholders own anything of value at the end of the day or are they really only participating in the potential, or the option, that the company might create future value for them? *(Of course, the banks and other lenders don't actually "own" the assets unless a producer is in default of their loan, but you get what I mean.)*

For Canadian producers it's easy to see what the value of the developed assets are, in relation to the amount of debt being carried by a particular producer. In our reserves disclosure, we have to report the Net Present Value (NPV) of all of the reserve categories at various Discount Rates (otherwise known as the uncertainty discount for future cashflows). *While I personally believe the uncertainty of Peyto's future cashflow is lower than many of our peers, due to the lower risk nature of our reserves, the industry standard is to use a 10% discount rate. I think Peyto's should be 5%.*

Shown below is a ratio of the 2013 year end net debt relative to the before tax Proved Developed Producing (PDP) NPV10 value to illustrate how much of the producing asset the bank, or debt holders, own versus how much the shareholders own. On average, it's around 50%.

Figure 2



Source: Peyto, BMO

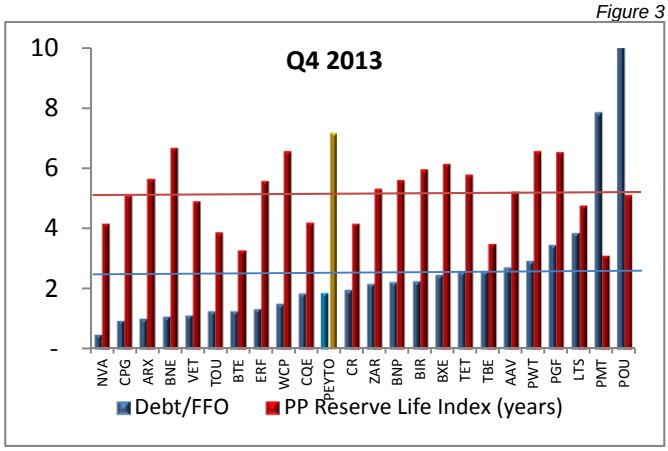
On a "years of cashflow basis", this same group carried an average 2.6 times net debt to annualized Q4 2013 funds from operations. And since the average PDP reserve life was

Suite 1500, 250 – 2nd St. SW
Calgary, AB T2P 0C1
Fax: 403 451 4100

TSX Symbol: PEY
E-mail: info@peyto.com

around 5.2 years, it goes around that they are about 50% levered, see Figure 3 (Peyto was 1.9 times and 7.2 yrs).

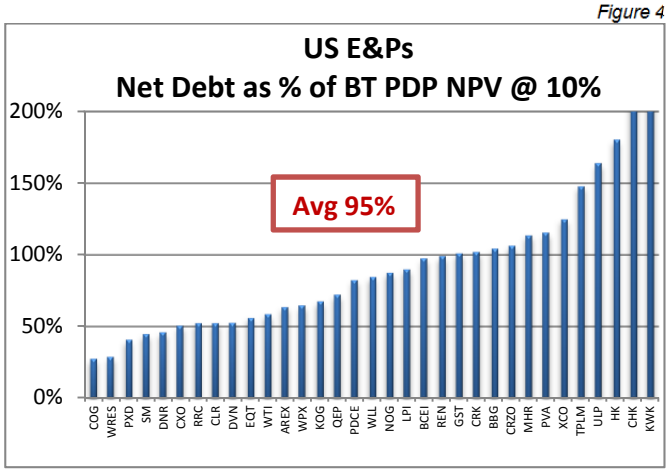
Figure 3



Source: Peyto

But how do the US producers stack up with their extra leverage by comparison? Unfortunately, US producers don't have to report the value of just their developed assets. They only formally report the Total Proved (1P) NPV, which generally includes a lot of undeveloped potential. So some digging is required to get to the value of the developed portion of their asset bases (I got these from BMO's research group). As a general observation, however, the developed portion comprises on average 65-70% of the Total Proved or 1P NPV.

Figure 4



Source: BMO

As you can see, the average US producer is definitely more leveraged than the Canadian producer, with arguably very little owned by the shareholders and most of the asset "owned" by the banks or debt holders.

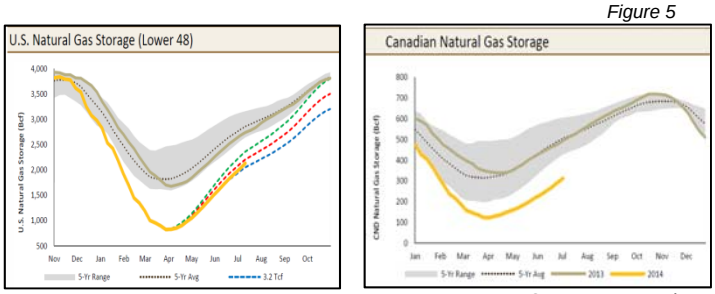
But that's not a fair comparison you say, because Canadian standard is to use an escalating price forecast versus the SEC standard of a constant price forecast. That's true. However, the impact of an escalating forecast versus a constant price forecast is actually not that great. For instance, we always run a constant price case on our reserves each year and the result is that it reduces the NPV10 by around 15% compared to the escalated case.

So I believe investor sentiment is correct, and US producers are more levered than Canadian producers, meaning shareholders own more assets in Canadian producers at the end of the day than optionality. Now if those same Canadian producers can demonstrate profitable growth in assets too (like Peyto can), then you get the best of both worlds. Alternatively, if the US producers continue to aggressively use debt to fund future development, then the bank ends up owning those future reserves too, not the shareholders. Or if the commodity price dips (like it just has) and takes away margin, rendering those future reserves worthless, then those companies will be like trees with shallow roots in a Westcoast windstorm. Most are likely to be lying sideways when the wind subsides.

Activity Levels and Commodity Prices

While you might say that I don't have much good to say about US gas producers and their aggressive use of debt, they are doing a good job of preparing for this coming winter. US natural gas storage, which was reduced to very low levels this past winter due to a colder than normal winter, are filling up faster than most projected. And they have the confidence of record and growing production levels to support it.

Figure 5



Source: Haywood

On the other hand, Canadian natural gas storage is not. Nor do we have record and growing levels of supply like they do in the lower 48, instead we have falling to flat production levels. All of this, sets up for a rather unique situation where AECO (Alberta) gas prices may actually trade at a significant premium to Henry Hub (US) prices. Don't forget, it gets cold in Canada in the winter. And as of right now, Eastern Canada doesn't have access to all of that growing supply in the US North East. Which means they will be competing for Western Canadian gas for heating fuel next winter.